

CHAPTER 42
ADJUSTMENTS TO COMPUTED TAX

[Prior to 12/17/86, Revenue Department[730]]

701—42.1(257,442) School district surtax. Iowa law provides for the implementation of an income surtax for increasing local school district budgets. The surtax must be approved by the voters of a school district in a special election or by a resolution of the board of directors of a school district. The surtax rate is determined by the department of management on the basis of the revenue to be raised by the surtax for the particular school district with the surtax.

The school district surtax is imposed on the income tax liabilities of all taxpayers residing in the school district on the last day of the taxpayers' tax years. For purposes of the school district surtax, income tax liability is the tax computed under Iowa Code section 422.5, less the credits against computed tax which are authorized in Iowa Code sections 422.11A, 422.11B, 422.11C, 422.12, and 422.12B. The credits that are applied against tax before the school district surtax is imposed are all the nonrefundable tax credits and those tax credits that are carried over if the credits exceed the computed tax.

In a situation where an individual is residing in a school district with a surtax and the individual dies during the tax year, the individual will be considered to be subject to the surtax, since the individual was residing in the school district on the last day of the individual's tax year.

An individual serving in the Armed Forces of the United States who maintains permanent residence in an Iowa school district with a surtax is subject to the surtax only if the individual is physically residing in the school district on the last day of the tax year.

A person who is present in the school district on the last day of the tax year on a temporary basis due to annual leave or in transit between duty stations is not subject to the surtax.

This rule is intended to implement Iowa Code sections 257.21, 257.29, 298.2, and 422.15.

701—42.2(422) Exemption and child care credits. Iowa Code section 422.12 provides for personal exemption and child care credits which are deducted from computed tax. The total amount of credits allowable cannot exceed the computed tax.

42.2(1) Exemption credits beginning prior to January 1, 1979.

a. A single person may deduct from the computed tax a personal exemption credit of \$15. A single person is defined in 701—subrule 39.4(1).

b. A married person living with husband or wife at the close of the taxable year, or living with husband or wife at the time of the death of that spouse during the taxable year, may, if a joint return is filed, deduct from the computed tax a personal exemption of \$30. Where such spouse files a separate return, each is entitled to deduct from the computed tax a personal exemption of \$15. The personal exemption may not be divided between the spouses in any other proportion.

c. A taxpayer may deduct from computed tax an exemption of \$10 for each dependent. "Dependent" has the same meaning as provided by the Internal Revenue Code, and the same dependents may be claimed for Iowa income tax purposes as the taxpayer is entitled to claim for federal income tax purposes. If each spouse furnished 50 percent of the support, they may elect between them which spouse is to be entitled to claim the dependent. The dividing of dependent credits applies only to the number of dependents and not to the money credits for a particular dependent.

d. A head of household as defined in 701—subrule 39.4(7) is allowed an additional personal exemption credit of \$15 in addition to any other credits allowed by this rule.

e. A taxpayer who is 65 years of age on or before the first day following the end of the tax year is allowed an additional personal exemption credit of \$15 in addition to any other credits allowed by this rule.

f. A taxpayer who is blind as defined in Iowa Code section 422.12(5) is allowed an additional personal exemption credit of \$15 in addition to any other credits allowed by this rule.

g. A nonresident taxpayer or a part-year resident taxpayer will be allowed to deduct personal exemption credits as if they were residents for the entire year.

42.2(2) The following exemption credit amounts which taxpayers are entitled to claim are in effect for tax years beginning on or after the following dates.

	<u>1/1/90</u>	<u>1/1/95</u>	<u>1/1/98</u>
a. Single	\$20	\$20	\$40
b. Married-Joint	\$40	\$40	\$80
Married-Separate	\$20	\$20	\$40
c. Dependent	\$15	\$40	\$40
d. Head of household	\$20	\$40	\$80
e. 65 or older	\$20	\$20	\$20
f. Blind	\$20	\$20	\$20

42.2(3) Child care credit. The following paragraphs describe the nonrefundable child care credit which was in effect for tax years beginning on or after January 1, 1977, but before January 1, 1990. See rule 42.9(422) for the child care credit which is applicable for tax years beginning on or after January 1, 1990.

a. Iowa resident taxpayers are allowed a tax credit for qualifying employment-related expenses paid for child and dependent care. The expense limitations are the same as provided by Internal Revenue Code Section 21. A joint Iowa income tax return is not required to be filed in order to obtain this credit. However, those married taxpayers electing to file separate returns or separately on a combined return must allocate the credit to each spouse in proportion to their respective net incomes to the total combined net income. The credit may not exceed the computed tax less the amount of exemption credits for any taxable year.

For the tax years beginning on or before December 31, 1981, a nonresident of Iowa is allowed a child care credit of 5 percent of the qualifying employment-related expenses incurred to allow the taxpayer or the taxpayer's spouse to work either full- or part-time for an employer or as a self-employed individual in the state of Iowa. To compute the amount of child care credit attributable to Iowa, the following formula should be used:

$$\frac{\text{Iowa earned income (wages, salaries, self-employment income, etc.)}}{\text{Federal earned income (wages, salaries, self-employment income, etc.)}} \times \frac{\text{qualifying employment related expenses}}{\text{employment related expenses}} \times 5\%$$

In the case of married taxpayers, both taxpayers' incomes must be used in the computation. If the spouses file separate returns or separately on a combined return, the child care credit attributable to Iowa must be allocated to each spouse in the proportion that each spouse's respective Iowa net income bears to the total combined Iowa net income.

The computation of the child care credit for nonresident taxpayers is shown in the following example:

A husband and wife both have earned income during 1977 and are filing separate Iowa returns or separately on a combined Iowa return. The total income for the spouses is shown below:

	Husband	Wife
Wages		\$ 5,000 (Non-Iowa)
Self-employment income	\$20,000 (Iowa)	
Interest income	\$ 2,500 (Non-Iowa)	\$ 2,500 (Non-Iowa)
Net rental income		\$10,000 (Iowa)

The qualifying employment-related expenses shown on federal Schedule 2441 amounted to \$3,000. The amount of child care credit attributable to Iowa would be:

$$\frac{\$20,000}{\$25,000} \times \$3,000 \times 5\% = \$120$$

The \$120 child care credit is then allocated to each spouse on the following basis:

Husband	Wife
$\frac{\$20,000}{\$30,000} \times \$120 = \80	$\frac{\$10,000}{\$30,000} \times \$120 = \40

For tax years beginning on or after January 1, 1982, nonresidents or part-year residents of Iowa shall compute their child care credit in the same manner as residents of Iowa.

A copy of federal Schedule 2441 must be attached to all returns on which taxpayers have claimed the child care credit. In no case may the child care credit exceed the taxpayers' Iowa income tax liability.

b. For tax years beginning on or after January 1, 1977, and prior to January 1, 1983, the percentage of qualifying employment-related expenses paid for child and dependent care which is allowable as a tax credit shall be 5 percent. For tax years beginning on or after January 1, 1983, but before January 1, 1986, the percentage of qualifying employment-related expenses paid for child and dependent care which is allowable as a tax credit shall be 10 percent.

c. For tax years beginning on or after January 1, 1986, but before January 1, 1990, the child care credit is 45 percent of the federal child and dependent care credit provided in Section 21 of the Internal Revenue Code. Married taxpayers who are claiming the child care credit and who elect to file separate returns or separately on the combined return must allocate the credit to each spouse in the ratio that each spouse's net income relates to the combined net incomes of both spouses. This credit may not exceed the computed tax less the amount of exemption credits for any taxable year.

42.2(4) Political contributions credit. Effective for tax years beginning on or after January 1, 1983, but before January 1, 1986, a taxpayer is allowed a tax credit equal to 5 percent of the first \$100 donated as a political contribution as defined in Section 24c of the Internal Revenue Code. In the case of a married couple filing a joint return, a political contribution credit equal to 5 percent of the first \$200 donated shall be allowed. The credit may not exceed the computed tax less the amount of exemption credits and child care credits for any taxable year.

42.2(5) Iowa venture capital fund investment credit. A taxpayer is allowed a tax credit equal to 5 percent of the taxpayer's investment in the initial offering of securities by the Iowa venture capital fund established by the Iowa development commission. Any credit in excess of the computed tax less exemption credits, child care credits, and political contribution credits may be credited to the tax liability for the following three taxable years or until depleted in less than three years.

42.2(6) Research activities credit. Effective for tax years beginning on or after January 1, 1985, taxpayers are allowed a credit equal to 6½ percent of the state's apportioned share of qualified expenditures for increasing research activities. Effective for tax years beginning on or after January 1, 1991, the state research activities credit will be computed on the basis of the qualifying expenditures for increasing research activities as allowable under Section 41 of the Internal Revenue Code in effect on January 1, 1999. The state's apportioned share of the qualifying expenditures for increasing research activities is a percent equal to the ratio of qualified research expenditures in Iowa to the total qualified research expenditures. The Iowa research activities credit is made permanent for tax years beginning on or after January 1, 1991, even though there may no longer be a research activities credit for federal income tax purposes.

a. Qualified expenditures in Iowa are:

- (1) Wages for qualified research services performed in Iowa.
- (2) Cost of supplies used in conducting qualified research in Iowa.
- (3) Rental or lease cost of personal property used in Iowa in conducting qualified research.

Where personal property is used both within and without Iowa in conducting qualified research, the rental or lease cost must be prorated between Iowa and non-Iowa use by the ratio of days used in Iowa to total days used both within and without Iowa.

(4) Sixty-five percent of contract expenses paid by a corporation to a qualified organization for basic research performed in Iowa.

b. Total qualified expenditures are:

- (1) Wages paid for qualified research services performed everywhere.
- (2) Cost of supplies used in conducting qualified research everywhere.
- (3) Rental or lease cost of personal property used in conducting qualified research everywhere.
- (4) Sixty-five percent of contract expenses paid by a corporation to a qualified organization for basic research performed everywhere.

Qualifying expenditures for increasing research activities is the smallest of the amount by which the qualified research expenses for the taxable year exceed the base period research expenses or 50 percent of the qualified research expenses for the taxable year.

Research expenditures for tax years beginning after December 31, 1985, but before January 1, 1987, will qualify for the Iowa credit for increasing research activities to the extent that the credit would be allowable for federal income tax purposes under Section 30 of the Internal Revenue Code as in effect on January 1, 1985.

A taxpayer may claim on the taxpayer's individual income tax return the pro rata share of the credit for qualifying research expenditures incurred in Iowa by a partnership, subchapter S corporation, or estate or trust. The portion of the credit claimed by the individual must be in the same ratio as the individual's pro rata share of the earnings of the partnership, subchapter S corporation, or estate or trust.

Any research credit in excess of the individual's tax liability, less the credits authorized in Iowa Code sections 422.11A, 422.11C, 422.12 and 422.12B may be refunded to the taxpayer or may be credited to the estimated tax of the taxpayer for the following year.

42.2(7) New jobs credit. A tax credit is available to an individual who has entered into an agreement under Iowa Code chapter 260E and has increased employment by at least 10 percent.

a. Definitions.

(1) The term "*new jobs*" means those jobs directly resulting from a project covered by an agreement authorized by Iowa Code chapter 260E (Iowa Industrial New Jobs Training Act) but does not include jobs of recalled workers or replacement jobs or other jobs that formerly existed in the industry in the state.

(2) The term "*jobs directly related to new jobs*" means those jobs which directly support the new jobs but does not include instate employees transferred to a position which would be considered to be a job directly related to new jobs unless the transferred employee's vacant position is filled by a new employee.

EXAMPLE A. A taxpayer who has entered into a chapter 260E agreement to train new employees for a new product line, transfers an instate employee to be foreman of the new product line but does not fill the transferred employee's position. The new foreman's position would not be considered a job directly related to new jobs even though it directly supports the new jobs because the transferred employee's old position was not refilled.

EXAMPLE B. A taxpayer who has entered into a chapter 260E agreement to train new employees for a new product line transfers an instate employee to be foreman of the new product line and fills the transferred employee's position with a new employee. The new foreman's position would be considered a job directly related to new jobs because it directly supports the new jobs and the transferred employee's old position was filled by a new employee.

The burden of proof that a job is directly related to new jobs is on the taxpayer.

(3) The term "*taxable wages*" means those wages upon which an employer is required to contribute to the state unemployment fund as defined in Iowa Code subsection 96.19(37) for the year in which the taxpayer elects to take the new jobs tax credit. For fiscal year taxpayers, "taxable wages" shall not be greater than the maximum wage upon which an employer is required to contribute to the state unemployment fund for the calendar year in which the taxpayer's fiscal year begins.

(4) The term "*agreement*" means an agreement entered into under Iowa Code chapter 260E after July 1, 1985, an amendment to that agreement, or an amendment to an agreement entered into before July 1, 1985, if the amendment sets forth the base employment level as of the date of the amendment. The term "agreement" also includes a preliminary agreement entered into under Iowa Code chapter 260E provided the preliminary agreement contains all the elements of a contract and includes the necessary elements and commitments relating to training programs and new jobs.

(5) The term "*base employment level*" means the number of full-time jobs an industry employs at a plant site which is covered by an agreement under Iowa Code chapter 260E on the date of the agreement.

(6) The term "*project*" means a training arrangement which is the subject of an agreement entered into under Iowa Code chapter 260E.

(7) The term "*industry*" means a business engaged in interstate or intrastate commerce for the purpose of manufacturing, processing, or assembling products, conducting research and development, or providing services in interstate commerce, but excludes retail, health or professional services. Industry does not include a business which closes or substantially reduces its operations in one area of the state and relocates substantially the same operation in another area of the state. Industry is a business engaged in the above listed activities rather than the generic definition encompassing all businesses in the state engaged in the same activities. For example, in the meat-packing business, an industry is considered to be a single corporate entity or operating division, rather than the entire meat-packing business in the state.

(8) The term "*new employees*" means the same as new jobs or jobs directly related to new jobs.

(9) The term "*full-time job*" means any of the following:

1. An employment position requiring an average work week of 35 or more hours;
2. An employment position for which compensation is paid on a salaried full-time basis without regard to hours worked; or
3. An aggregation of any number of part-time or job-sharing employment positions which equal one full-time employment position. For purposes of this subrule each part-time or job-sharing employment position shall be categorized with regard to the average number of hours worked each week as one-quarter, half, three-quarters, or full-time position, as set forth in the following table:

Average Number of Weekly Hours	Category
More than 0 but less than 15	$\frac{1}{4}$
15 or more but less than 25	$\frac{1}{2}$
25 or more but less than 35	$\frac{3}{4}$
35 or more	1 (full-time)

b. How to compute the credit. The credit is 6 percent of the taxable wages paid to employees in new jobs or jobs directly related to new jobs for the taxable year in which the taxpayer elects to take the credit.

EXAMPLE 1. A taxpayer enters into an agreement to increase employment by 20 new employees which is greater than 10 percent of the taxpayer's base employment level of 100 employees. In year one of the agreement the taxpayer hires 20 new employees but elects not to take the credit in that year. In year two of the agreement only 18 of the new employees hired in year one are still employed and the taxpayer elects to take the credit. The credit would be 6 percent of the taxable wages of the 18 remaining new employees. In year three of the agreement the taxpayer hires two additional new employees under the agreement to replace the two employees that left in year two and elects to take the credit. The credit would be 6 percent of the taxable wages paid to the two replacement employees. In year four of the agreement three of the employees for which a credit had been taken left employment and three additional employees were hired. No credit is available for these employees. A credit can only be taken one time for each new job or job directly related to a new job.

EXAMPLE 2. A taxpayer operating two plants in Iowa enters into a chapter 260E agreement to train new employees for a new product line at one of the taxpayer's plants. The base employment level on the date of the agreement at plant A is 300 and at plant B is 100. Under the agreement 20 new employees will be trained for plant B which is greater than a 10 percent increase of the base employment level for plant B. In the year in which the taxpayer elects to take the credit, the employment level at plant A is 290 and at plant B is 120. The credit would be 6 percent of the wages of 10 new employees at plant B as 10 new jobs were created by the industry in the state. A credit for the remaining 10 employees can be taken if the employment level at plant A increases back to 300 during the period of time that the credit can be taken.

c. When the credit can be taken. The taxpayer may elect to take the credit in any tax year which either begins or ends during the period beginning with the date of the agreement and ending with the date by which the project is to be completed under the agreement. However, the taxpayer may not take the credit until the base employment level has been exceeded by at least 10 percent.

EXAMPLE: A taxpayer enters into an agreement to increase employment from a base employment level of 200 employees to 225 employees. In year one of the agreement the taxpayer hires 20 new employees which is a 10 percent increase over the base employment level but elects not to take the credit. In year two of the agreement two of the new employees leave employment. The taxpayer elects to take the credit which would be 6 percent of the taxable wages of the 18 employees currently employed. In year three the taxpayer hires seven new employees and elects to take the credit. The credit would be 6 percent of the taxable wages of the seven new employees.

A taxpayer may claim on the taxpayer's individual income tax return the pro rata share of the Iowa new jobs credit from a partnership, subchapter S corporation, estate or trust. The portion of the credit claimed by the individual shall be in the same ratio as the individual's pro rata share of the earnings of the partnership, subchapter S corporation, or estate or trust. All partners in a partnership, shareholders in a subchapter S corporation and beneficiaries in an estate or trust shall elect to take the Iowa new jobs credit the same year.

Any Iowa new jobs credit in excess of the individual's tax liability less the credits authorized in Iowa Code sections 422.12 and 422.12B may be carried forward for ten years or until it is used, whichever is the earlier.

42.2(8) Tuition and textbooks credit for dependents in grades kindergarten through 12 in Iowa. For tax years beginning on or after January 1, 1987, but prior to January 1, 1996, individuals who elect the optional standard deduction may claim a tax credit of 5 percent of the qualifying expenditures. For tax years beginning on or after January 1, 1996, all taxpayers, including individuals that have net incomes of \$45,000 or more, may claim a tuition and textbook credit of 10 percent of qualifying expenditures. For tax years beginning on or after January 1, 1998, all taxpayers may claim a tuition and textbook credit of 25 percent of up to \$1,000 of qualifying expenditures for each dependent attending grades kindergarten through 12 in Iowa. Qualifying expenditures include amounts paid for tuition and textbooks described in paragraphs “a” and “b” of 701—subrule 41.5(5) as well as amounts paid for extracurricular activities described in paragraph “c” of 701—subrule 41.5(5). For purposes of this subrule, the qualifying expenditures for tax years beginning in 1996 and 1997 are the same as would have been eligible for the deduction allowed under 701—subrule 41.5(5) if the qualifying expenditures had been paid in a tax year when the deduction was applicable. All the qualifications, definitions, and criteria in 701—subrule 41.5(5) are equally applicable to the credit for amounts paid for tuition and textbooks for dependents attending grades kindergarten through 12 in Iowa. In the case of married taxpayers who are filing separate returns or separately on the combined return, the spouses can allocate the credit for tuition and textbooks between them in the same ratio as described in paragraph “g” of 701—subrule 41.5(5).

42.2(9) Earned income credit. Effective for tax years beginning on or after January 1, 1990, an individual is allowed a state earned income credit equal to a percentage of the earned income credit to which the taxpayer is entitled on the taxpayer’s federal income tax return as authorized in Section 32 of the Internal Revenue Code. The state earned income credit is nonrefundable so the credit may not exceed the remaining income tax liability of the taxpayer after the personal exemption credits and the other nonrefundable credits are deducted. The percentage of the earned income credit for tax years beginning in the 1990 calendar year is 5 percent. The percentage of the earned income credit for tax years beginning on or after January 1, 1991, is 6.5 percent.

For federal income tax purposes, the earned income credit is available for a low-income worker who maintains a household in the United States that is the principal place of abode of the worker and a child or children for more than one-half of the tax year or the worker must have provided a home for the entire tax year for a dependent parent. In addition, the worker must be (1) a married person who files a joint return and is entitled to a dependency exemption for a son or daughter, adopted child or stepchild; (2) a surviving spouse; or (3) an individual who qualifies as a head of household as described in Section 2(b) of the Internal Revenue Code. The federal earned income credit for a taxpayer is determined by computing the taxpayer’s earned income on a worksheet provided in the federal income tax return instructions and determining the allowable credit from a table included in the instructions for the 1040 or 1040A. For purposes of the credit, a taxpayer’s earned income includes wages, salaries, tips, or other compensation plus net income from self-employment.

In the case of married taxpayers who filed a joint federal return who elect to file separate state returns or separately on the combined return form, the state earned income credit is allocated between the spouses in the ratio that each spouse’s earned income relates to the earned income of both spouses.

Nonresidents and part-year residents are allowed the same earned income credits as resident taxpayers.

42.2(10) Investment tax credit. An investment tax credit of up to 10 percent of the new investment which is directly related to new jobs created by the location or expansion of an eligible business is available. The credit is available for machinery and equipment or improvements to real property placed in service after May 1, 1994. The credit is to be taken in the year the qualifying asset is placed in service. For business applications received by the Iowa department of economic development on or after July 1, 1999, purchases of real property made in conjunction with the location or expansion of an eligible business, the cost of land and any buildings and structures located on the land will be considered to be new investment which is directly related to new jobs for purposes of determining the amount of new investment upon which an investment tax credit may be taken.

If the eligible business within five years of purchase, sells, disposes of, razes, or otherwise renders unusable all or a part of the land, buildings, or other existing structures for which tax credit was claimed under this rule, the income tax liability of the eligible business for the year in which all or part of the property is sold, disposed of, razed, or otherwise rendered unusable shall be increased by one of the following amounts:

- a. One hundred percent of the investment tax credit claimed if the property ceases to be eligible for the tax credit within one full year after being placed in service.
- b. Eighty percent of the investment tax credit claimed if the property ceases to be eligible for the tax credit within two full years after being placed in service.
- c. Sixty percent of the investment tax credit claimed if the property ceases to be eligible for the tax credit within three full years after being placed in service.
- d. Forty percent of the investment tax credit claimed if the property ceases to be eligible for the tax credit within four full years after being placed in service.
- e. Twenty percent of the investment tax credit claimed if the property ceases to be eligible for the tax credit within five full years after being placed in service.

Any credit in excess of the tax liability for the tax year may be carried forward seven years or until used, whichever is the earlier.

If the business is a partnership, S corporation, limited liability company, or an estate or trust electing to have the income taxed directly to an individual, an individual may claim the credit. The amount of the credit claimed by the individual must be based on the individual's pro-rata share of the individual's earnings of the partnership, S corporation, limited liability company, or estate or trust.

For tax years beginning on or after July 1, 2001, an eligible business whose project primarily involves the production of value-added agricultural products may elect to receive a refund for all or a portion of an unused investment tax credit. For tax years beginning on or after July 1, 2001, but before July 1, 2003, an eligible business includes a cooperative described in Section 521 of the Internal Revenue Code which is not required to file an Iowa corporation income tax return and whose project primarily involves the production of ethanol. For tax years beginning on or after July 1, 2003, an eligible business includes a cooperative described in Section 521 of the Internal Revenue Code which is not required to file an Iowa corporation income tax return.

Eligible businesses shall apply to the Iowa department of economic development for tax credit certificates between May 1 and May 15 of each fiscal year. Only those businesses that have completed projects before the May 1 filing date may apply for a tax credit certificate. The Iowa department of economic development will not issue tax credit certificates for more than \$4 million during a fiscal year. If applications are received for more than \$4 million, the applicants shall receive certificates for a prorated amount.

The Iowa department of economic development will issue tax credit certificates within a reasonable period of time. Tax credit certificates are valid for the tax year following project completion. The tax credit certificate must be attached to the tax return for the tax year during which the tax credit is claimed. The tax credit certificate shall not be transferred, except for a cooperative described in Section 521 of the Internal Revenue Code which is required to file an Iowa corporation income tax return and whose project primarily involves the production of ethanol for tax years beginning on or after January 1, 2002, or for a cooperative described in Section 521 of the Internal Revenue Code which is required to file an Iowa corporation income tax return for tax years beginning on or after July 1, 2003.

For value-added agricultural projects for cooperatives that are not required to file an Iowa income tax return because they are exempt from federal income tax, the cooperative must submit a list of its members and the share of each member's interest in the cooperative. The Iowa department of economic development will issue a tax credit certificate to each member on the list.

See 701—subrule 52.10(4) for examples illustrating how this subrule is applied.

For tax years beginning on or after January 1, 2002, but before July 1, 2003, a cooperative described in Section 521 of the Internal Revenue Code which is required to file an Iowa corporation income tax return and whose project primarily involves the production of ethanol may elect to transfer all or a portion of its tax credit to its members. For tax years beginning on or after July 1, 2003, a cooperative described in Section 521 of the Internal Revenue Code which is required to file an Iowa corporation income tax return may elect to transfer all or a portion of its tax credit to its members. The amount of tax credit transferred and claimed by a member shall be based upon the pro-rata share of the member's earnings in the cooperative. The Iowa department of economic development will issue a tax credit certificate to each member of the cooperative to whom the credit was transferred provided that tax credit certificates which total no more than \$4 million are issued during a fiscal year. The tax credit certificate must be attached to the tax return for the tax year during which the tax credit is claimed.

42.2(11) Research activities credit. Effective for tax years beginning on or after January 1, 2000, the taxes imposed for individual income tax purposes will be reduced by a tax credit for increasing research activities in this state. See subrule 42.2(6) for the research activities credit that was applicable for individual income tax purposes for tax years beginning on or after January 1, 1985, but prior to January 1, 2000.

a. The credit equals the sum of the following:

(1) Six and one-half percent of the excess of qualified research expenses during the tax year over the base amount for the tax year based upon the state's apportioned share of the qualifying expenditures for increasing research activities.

(2) Six and one-half percent of the basic research payments determined under Section 41(e)(1)(A) of the Internal Revenue Code during the tax year based upon the state's apportioned share of the qualifying expenditures for increasing research activities. The state's apportioned share of the qualifying expenditures for increasing research activities is a percent equal to the ratio of qualified research expenditures in this state to total qualified research activities.

b. In lieu of the credit computed under paragraph "*a*" of this subrule, a taxpayer may elect to compute the credit amount for qualified research expenses incurred in this state in a manner consistent with the alternative incremental credit described in Section 41(c)(4) of the Internal Revenue Code. The taxpayer may make this election regardless of the method used by the taxpayer on the taxpayer's federal income tax return. The election made under this paragraph is for the tax year and the taxpayer may use another method or this same method for any subsequent tax year. For purposes of this alternative research credit computation, the credit percentages applicable to qualified research expenses described in clauses (i), (ii), and (iii) of Section 41(c)(4)(A) of the Internal Revenue Code are 1.65 percent, 2.20 percent, and 2.75 percent, respectively.

For purposes of this subrule, the terms "base amount," "basic research payment," and "qualified research expense" mean the same as defined for the federal credit for increasing research activities under Section 41 of the Internal Revenue Code, except that, for purposes of the alternative incremental credit described in paragraph "*b*" of this subrule, such amounts are limited to research activities conducted within this state. For purposes of this subrule, "Internal Revenue Code" means the Internal Revenue Code in effect on January 1, 2003.

c. An individual may claim a research activities credit incurred by a partnership, S corporation, limited liability company, estate, or trust electing to have the income of the business entity taxed to the individual. The amount claimed by an individual from the business entity is to be based upon the pro-rata share of the individual's earnings from a partnership, S corporation, estate or trust. Any research credit in excess of the individual's tax liability, less the credits authorized in Iowa Code sections 422.11A, 422.12 and 422.12B may be refunded to the individual or may be credited to the individual's tax liability for the following tax year.

This rule is intended to implement Iowa Code section 15.333 as amended by 2003 Iowa Acts, House File 681, and Iowa Code sections 422.10, 422.11A, 422.12, and 422.12B.

701—42.3(422) Nonresident and part-year resident credit. For tax years beginning on or after January 1, 1982, an individual who is a nonresident of Iowa for the entire tax year, or an individual who is an Iowa resident for a portion of the tax year, is allowed a credit against the individual's Iowa income tax liability for the Iowa income tax on the portion of the individual's income which was earned outside Iowa while the person was a nonresident of Iowa. This credit is computed on Schedule IA 126 which is included in the Iowa individual income tax booklet. The following subrules clarify how the nonresident and part-year resident credit is computed for nonresidents of Iowa and taxpayers who are part-year residents of Iowa during the tax year.

42.3(1) Nonresident/part-year resident credit for nonresidents of Iowa. A nonresident of Iowa is to complete the Iowa individual return by reporting the individual's total net income, including incomes earned outside Iowa, on the front of the IA 1040 return form similar to the way an Iowa resident completes the return form. A nonresident individual is allowed the same deduction for federal income tax and the same itemized deductions as an Iowa resident taxpayer with identical deductions for these expenditures. Thus, a nonresident with a taxable income of \$40,000 would have the same initial Iowa income tax liability as a resident taxpayer with a taxable income of \$40,000 before the nonresident/part-year resident credit is computed.

The nonresident/part-year resident credit is computed on Schedule IA 126. The lines referred to in this subrule are from Schedule IA 126 and Form IA 1040 for the 1997 tax year. Similar lines on the schedule and form may apply for subsequent tax years. The individual's Iowa source net income from lines 1 through 25 of the schedule is totaled on line 26 of the schedule. If the nonresident's Iowa source net income is less than \$1,000, the taxpayer is not subject to Iowa income tax and is not required to file an Iowa income tax return for the tax year. However, if the Iowa source net income amount is \$1,000 or more, the Iowa source net income is then divided by the person's all source net income on line 27 of Schedule IA 126 to determine the percentage of the Iowa net income to all source net income. This Iowa income percentage is inserted on line 28 of the schedule, and this percentage is then subtracted from 100 percent to arrive at the nonresident/part-year resident credit percentage or the percentage of the individual's total income which was earned outside Iowa. The nonresident/part-year resident credit percentage is entered on line 29 of Schedule IA 126. The Iowa income tax on total income from line 43 of the IA 1040 is entered on line 30 of Schedule IA 126. The total of nonrefundable credits from line 50 of the IA 1040 is then shown on line 31 of Schedule IA 126. The amount on line 31 is subtracted from the amount on line 30 which leaves the Iowa total tax after nonrefundable credits on line 32. This Iowa tax after credits amount is multiplied by the nonresident/part-year resident credit percentage from line 29 to compute the nonresident/part-year resident credit. The amount of the credit is inserted on line 33 of Schedule IA 126 and on line 52 of the IA 1040.

EXAMPLE A. A single resident of Nebraska had Iowa source net income of \$15,000 in 1997 from wages earned from employment in Iowa. The rest of this person's income was attributable to sources outside Iowa. This nonresident of Iowa had an all source net income of \$40,000 and a taxable income of \$30,000 due to a federal tax deduction of \$7,000 and itemized deductions of \$3,000. The Iowa income percentage is computed by dividing the Iowa source net income of \$15,000 by the taxpayer's all source net income of \$40,000, which results in a percentage of 37.5. This percentage is subtracted from 100 percent which leaves a nonresident/part-year resident credit percentage of 62.5.

The Iowa tax from line 43 of the IA 1040 is \$1,789. The total nonrefundable credit from line 50 is \$20, which leaves a tax amount of \$1,769 when the credit is subtracted from \$1,789. When \$1,769 is multiplied by the nonresident/part-year resident credit percentage of 62.5 percent, a nonresident credit of \$1,106 is computed which is entered on line 33 of Schedule IA 126 as well as on line 52 of the IA 1040 for 1997.

EXAMPLE B. A California resident, who was married, had \$20,000 of Iowa source income in 1997 from an Iowa farm. This individual had an additional \$80,000 in income that was attributable to sources outside Iowa, but the individual's spouse had no income. The taxpayers had paid \$18,000 in federal income tax in 1997 and had itemized deductions of \$12,000 in 1997.

The taxpayers' taxable income on their joint Iowa return was \$70,000. The taxpayers had an Iowa income tax liability of \$5,422 after application of the personal exemption credits of \$40. The taxpayers had an Iowa source income of \$20,000 and an all source net income of \$100,000. Therefore, the Iowa income percentage was 20 percent. Subtracting the Iowa income percentage of 20 percent from 100 percent leaves a nonresident/part-year resident credit percentage of 80 percent.

When the Iowa income tax liability of \$5,422 is multiplied by 80 percent, this results in a nonresident/part-year resident credit of \$4,338. This credit amount is entered on line 33 of the Schedule IA 126 and on line 52 of Form IA 1040.

42.3(2) *Nonresident/part-year resident credit for part-year residents of Iowa.* An individual who is a resident of Iowa for part of the tax year is to complete the front of the IA 1040 income tax return form as a resident taxpayer by showing the taxpayer's total income, including income earned outside Iowa, on the front of the IA 1040 return form. A part-year resident of Iowa is allowed the same federal tax deduction and itemized deductions as a resident taxpayer who has paid the same amount of federal income tax and has paid for the same deductions that can be claimed on Schedule A in the tax year. Therefore, a part-year resident would have the same initial Iowa income tax liability as an Iowa resident with the same taxable income before computation of the nonresident/part-year resident credit.

The nonresident/part-year resident credit for a part-year resident is computed on Schedule IA 126. The lines referred to in this subrule are from the IA 1040 income tax return form and the Schedule IA 126 for 1997. Similar lines may apply for tax years after 1997. The individual's Iowa source income is totaled on line 26 of this form and includes all the individual's income received while the taxpayer was a resident of Iowa and all the Iowa source income received during the period of the tax year when the individual was a resident of a state other than Iowa. Iowa source income includes, but is not limited to, wages earned in Iowa while a resident of another state as well as incomes from Iowa farms and other Iowa businesses that were earned during the portion of the year that the taxpayer was a nonresident of Iowa. In the case of interest from a part-year resident's account at an Iowa financial institution, only interest earned during the period of the individual's Iowa residence is Iowa source income unless the account is for an Iowa business. If the part-year resident's account at a financial institution is for an Iowa business, all interest earned in the year by the part-year resident from the account is taxable to Iowa.

Income earned outside Iowa by the part-year resident during the portion of the year the individual was an Iowa resident is taxable to Iowa and is part of the individual's Iowa source income. To compute the nonresident/part-year resident credit for a part-year resident, the taxpayer's Iowa source income on Schedule IA 126 is totaled. If the Iowa source income is less than \$1,000, the taxpayer is not subject to Iowa income tax and is not required to file an Iowa return. If the Iowa source income is \$1,000 or more, it is divided by the taxpayer's all source net income on line 27 of Schedule IA 126. The percentage computed by this procedure is the Iowa income percentage and is entered on line 28 of the IA 126. The Iowa income percentage is then subtracted from 100 percent to arrive at the nonresident/part-year resident credit percentage which is entered on line 29 of Schedule IA 126. The Iowa tax from line 43 of the IA 1040 is then shown on line 30 of Schedule IA 126. The total of the Iowa nonrefundable credits from line 50 of the IA 1040 is entered on line 31 of Schedule IA 126 and is subtracted from the Iowa tax amount on line 30. The tax after credits amount on line 32 is next multiplied by the nonresident/part-year resident credit percentage from line 28. The amount calculated from this procedure is the nonresident/part-year resident credit which is shown on line 33 of Schedule IA 126 and on line 52 of Form IA 1040.

EXAMPLE A. A single individual was a resident of Nebraska for the first half of 1997 and moved to Iowa on July 1, 1997, to accept a job in Des Moines. This individual earned \$20,000 from wages, \$200 from interest, and \$4,000 from a ranch in Nebraska from January 1, 1997, through June 30, 1997. In the last half of 1997, this person had wages of \$30,000, interest income of \$300, and \$4,000 from the Nebraska ranch. This part-year resident had federal income tax paid in 1997 of \$11,000 and had itemized deductions of \$3,000.

The part-year resident's all source net income was \$58,500 and the Iowa source net income was \$34,300, which includes the Iowa wages, the Nebraska ranch income of \$4,000 earned during the individual's period of Iowa residence, as well as the interest income of \$300 earned in that time of the tax year. The Iowa taxable income for the part-year resident for 1997 was \$44,500, which considered the federal income tax deduction of \$11,000 and itemized deductions of \$3,000. The individual's Iowa income percentage was 58.6 which was determined by dividing the Iowa source income of \$34,300 by the all source income of \$58,500. Subtracting the Iowa income percentage of 58.6 from 100 percent results in a nonresident/part-year resident credit percentage of 41.4 percent. The Iowa tax on total income was \$3,023 which was reduced to \$3,003 after subtraction of the personal exemption credit of \$20.

When \$3,003 is multiplied by the nonresident/part-year resident percentage of 41.4, a nonresident/part-year resident credit of \$1,243 is computed for this part-year resident.

EXAMPLE B. A single individual moved from Minnesota to Iowa on July 1, 1997. This person had received \$5,000 in income from an Iowa farm in March of the tax year and another \$10,000 from this farm in September of 1997. This person had \$10,000 in wages from employment in Minnesota in the first half of the year and another \$15,000 in wages from employment in Iowa in the last half of 1997. This person had \$2,000 in interest from a Minnesota bank in the first half of the year and \$2,000 in interest from an Iowa bank in the last six months of 1997. This taxpayer had \$8,000 in federal income tax withheld from wages in 1997 and claimed the standard deduction on both the Iowa and federal income tax returns.

The part-year resident's all source income was \$44,000 and the Iowa source income was \$32,000 which consisted of \$15,000 in wages, \$2,000 in interest income, and \$15,000 in income from the Iowa farm. Since the farm was in Iowa, the farm income received in the first half of 1997 was taxable to Iowa as well as the farm income received while the individual was an Iowa resident. The individual's Iowa taxable income was \$34,590 which was computed after subtracting the federal income tax deduction of \$8,000 and a standard deduction of \$1,410. The taxpayer's Iowa income tax liability was \$2,132 after subtraction of a personal exemption credit of \$20.

The taxpayer's Iowa income percentage was 72.7 percent which was computed by dividing the Iowa source income of \$32,000 by the all source income of \$44,000. The nonresident/part-year resident credit percentage was 27.3 percent which was arrived at by subtracting the Iowa income percentage of 72.7 percent from 100 percent. The taxpayer's nonresident/part-year resident credit is \$582. This was determined by multiplying the Iowa income tax liability after personal exemption credit amount of \$2,132 by the nonresident/part-year resident percentage of 27.3 percent.

This rule is intended to implement Iowa Code section 422.5.

701—42.4(422) Out-of-state tax credits.

42.4(1) General rule. Iowa residents are allowed an out-of-state tax credit for taxes paid to another state or foreign country on income which is also reported on the taxpayer's Iowa return. The out-of-state tax credit is allowable only if the taxpayer files an Iowa resident income tax return.

42.4(2) Limitation of out-of-state tax credit. If an Iowa resident taxpayer pays income tax to another state or foreign country on any of the taxpayer's income, the taxpayer is entitled to a net tax credit; that is, the taxpayer may deduct from the taxpayer's Iowa net tax (not from gross income) the amount of income tax actually paid to the other state or country, provided the amount deducted as a credit does not exceed the amount of Iowa net income tax on the same income which was taxed by the other state or foreign country.

42.4(3) Computation of tax credit.

a. For tax years beginning before January 1, 1983. The limitation on the tax credit must be computed according to the following formula: Income earned in another state or country and taxed by such other state or country shall be divided by the total income of the Iowa resident taxpayer. Said quotient multiplied times the net Iowa tax as determined on the total income of the taxpayer as if entirely earned in Iowa shall be the maximum tax credit against the Iowa net tax.